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Rural Telephone Coalition

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FEDERAL COMMUNICATIONS COMMISSION
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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Federal-State Joint Board on	)	CC Docket No. 96-45
Universal Service	)	

COMMENTS

of the

RURAL TELEPHONE COALITION

December 19, 1996

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SUMMARY

The Joint Board recommendation fails to take account of federal constitutional concerns. Mandates to use forward looking economic costs in combination with a benchmark as the basis for determining support levels cannot be isolated without reference to the historical compact under which local exchange carriers have invested billions in ubiquitous facilities to fulfill their part of a compact that required adequate services at reasonable rates to all in the territories they served. The Commission cannot adopt support mechanisms with blinders that cause it to ignore the historical costs of companies that invested to provide universal service under a regulatory scheme that was authorized by a prior Congress. The Commission may certainly seek to promote efficiencies and competitive entry, but the most recent Congress could not and certainly did not authorize the Commission to suspend or ignore the Fifth Amendment protection against takings. On the contrary, Congress mandated that universal service support mechanisms be "specific," "predictable," and "sufficient." Any support mechanism that does not provide the opportunity to recover costs incurred for facilities deployed to provide universal service, whether presently or under the prior regulatory regime cannot be "sufficient." Likewise, the outcome of the interconnection rules, access charge and separations reform will undeniably affect the Commission's compliance with the mandate to adopt "sufficient" mechanisms. The rural telephone companies that will be affected by the changes in support mechanisms typically receive 65 percent of their revenues from access. It is thus extremely important that the Commission carefully coordinate its decision in this proceeding with access and separations reform in order to prevent major upheavals and disruption of the quality or extent of service to

rural areas of the Nation.

The recommendation to supplement the seven universal service principles in the Act with the added principle of competitive neutrality ignores Congress' repeated statements of special concern for the preservation of universal service in rural areas. The added gloss that the recommendation puts on competitive neutrality favors competitors rather than competition. CLECs, for example, are favored by the recommendation to base their universal contributions on gross revenues net of payments to other carriers. The Commission should reject this interpretation of "competitive neutrality." Contributions to universal service should be assessed on a nondiscriminatory basis and based on interstate as well as intrastate retail revenues.

The Joint Board has concluded that the leap from the use of historical costs to forward looking economic costs requires the use of proxy models to determine costs. There are serious deficiencies in the analysis that accompanies this conclusion and the recommended criteria for evaluating a yet-to-be-selected model. The Board fails to address the widely accepted view that the models do not accurately provide for recovery of joint and common costs. The recommendation also assumes that a model will predict forward looking economic costs but fails to require the verification of outputs as a precondition to adoption of any proposed model. The seventh criterion suggested for evaluating the reasonableness of the model only recommends that outputs be "plausible." Plausibility infers superficiality rather than verity. The model must be tested against current engineering data so that one can determine whether it predicts what it purports to, namely forward looking economic costs associated with particular units or companies.

The RTC believes it is unlikely that any administratively feasible proxy will be able to predict forward looking economic costs for rural telephone companies. The smallness of the companies and the uniqueness of their service areas present inherent problems for any model that relies on data from more homogenous large companies and is intended to predict typical costs. It is also essential that any model which is finally adopted permit rural telephone companies to calculate and receive support on the basis of disaggregated parts of their service areas to counter the effect of cherry picking by competitors with the capability of ignoring higher cost areas within rural telephone company service areas.

The RTC believes it is inappropriate to adopt the benchmark recommended as an offset against proxy model forward looking costs. That benchmark is based on nationwide average revenues per line. Use of the benchmark is inconsistent with forward looking cost recovery and will also result in insufficient recovery. Nationwide revenues per line are not reflective of rural areas which typically have very limited local calling scopes and a different rate structure.

The Joint Board correctly recognizes that further proceedings are needed to look at rural issues before implementation of any changes. The RTC is in favor of such a proceeding. It also supports the Joint Board's recommendation that the transition to proxies for rural companies not begin until after the models have been determined accurate.

The RTC recommends that the Commission reject the Joint Board's recommendation to freeze the pre line universal service support for the first three transitional years beginning in 1998. A freeze will set back progress in rural areas by halting the deployment of upgrades and new infrastructure especially in the case of areas where long overdue upgrades have been planned by acquiring companies and necessarily involve increases in per line costs. The freeze defeats the purposes of the Act by inhibiting rather than promoting the deployment of advanced technologies to all areas of the Nation.

The RTC agrees with the Joint Board that schools and libraries should be able to use discounts for any telecommunications service they choose and for Internet access. However, the RTC believes support should be provided for "toll free" access to the Internet in rural areas where access cannot be obtained "toll free." It also believes there is a need to clarify how the cap on the fund will be administered fairly. RTC believes the legality of including internal connections, however, is questionable since the Act is predicated on giving discounts for the services of telecommunications carriers, and internal connections are provided by many other entities.

The RTC recognizes that the 1996 Act requires modifications in the entity charged with administration of universal service support. New contributors and recipients will have a stake in universal service and an interest in a smooth transition and successful administration of the funds. However, the Commission should not rush to automatically exclude the National Exchange Carriers Association as a potential administrator merely because of the constitution of its board and its advocacy on behalf of LECs. One of the preeminent concerns at this stage should be the competency of the administrator. Since NECA is the only organization that is presently capable of taking over the administration, particularly in light of implementation of the schools and libraries program for the 1997-1998 school years, it should be appointed for that function now. In the interim, NECA should be permitted to restructure or organize itself to meet the criteria intended to prevent bias in the administration of the fund. That restructuring will take time and will possibly involve discussions and negotiations with multiple stakeholders. In the meantime, it may be appropriate for the Advisory Committee to play a role, but that Committee may not appoint the administrator. The Advisory Committee Act clearly states that advisory committees should be advisory only, and requires that all matters under their consideration should be determined, in accordance with law, by the official agency.

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Federal-State Joint Board on	)	CC Docket No. 96-45
Universal Service	)	

Comments of the
Rural Telephone Coalition

The Rural Telephone Coalition ("RTC") files these Comments in response to the Commission's *Public Notice*, DA 96-1891, released on November 18, 1996, inviting comments on the *Recommended Decision* of the Federal-State Joint Board on Universal Service released in this docket on November 8, 1996.[1] This proceeding is examining implementation of Section 254 of the Telecommunications Act of 1996 ("Act").

I. THE RECOMMENDATION FAILS TO TAKE ACCOUNT OF FEDERAL CONSTITUTIONAL CONCERNS IN ADDRESSING SUPPORT FOR RURAL AND INSULAR AREAS.

A. THE ACADEMIC APPROACH OF THE JOINT BOARD'S RECOMMENDATION FAILS TO ADDRESS ISSUES RAISED REGARDING THE LECs' RECOVERY OF EMBEDDED COSTS.

1. MANDATORY USE OF FORWARD LOOKING COST TO DETERMINE UNIVERSAL SERVICE SUPPORT WILL LEAD TO CONFISCATION OF INCUMBENT LEC's PROPERTY.

The Joint Board recommends that for the purpose of universal service support, a LEC's

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[1] The Rural Telephone Coalition is comprised of the National Rural Telecom Association (NRTA), the National Telephone Cooperative Association (NTCA), and the Organization for the Promotion and Advancement of Small Telecommunications Companies (OPASTCO). The RTC filed joint comments and replies on April 12 and May 7, 1996, in response to the *Notice of Proposed Rulemaking and Order Establishing Joint Board* released on March 8, 1996. The RTC also filed further comment on August 2, 1996, in response to the 72 specific questions released on July 3, 1996, and further comment on the proposed cost proxy models on August 9, 1996.

cost should be determined using a forward looking methodology that replaces the current system which utilizes actual embedded cost.[2] The premise is that forward looking cost will approximate the cost that would be incurred by an efficient competitor entering the market, and that no support should be available for inefficient provision of service. The recommendation goes on to propose that the amount of support be determined by the difference between this forward looking cost and a benchmark. The benchmark will be determined on the basis of the per line nationwide average revenue for local, discretionary, access and other services.[3]

Other than a recitation of various parties' comments, the Joint Board does not discuss any of the issues raised by the RTC and others in comments in this and other proceedings[4] regarding the necessity for incumbent LECs (ILECs) to have an opportunity to recover their embedded costs. There are, however, serious real world issues which the academic approach of the recommendation simply ignores. Most prominent of these is that the proposed methodology would make it impossible for ILECs to recover their costs and a reasonable return on investments which have been made pursuant to a regulatory compact. This is a result not permitted by the Fifth Amendment. If hypothetical instead of real costs are used, there is no way to determine the effects of a rate making methodology because there is no measure of the prudently incurred actual investment made by the LEC to provide service to the public. If the forward looking cost, because of some change in technology since the investments were prudently made, is

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[2] *Recommended Decision* at paras. 270, 275.

[3] *Id.* at paras. 310-11.

[4] *See*, RTC Comments, Reply Comments, and Further Comments, CC Docket No. 96-45, April 12, May 7, and July 3, 1996. *See also*, RTC Comments and Reply Comments, CC Docket No. 96-98, May 16 and May 30, 1996.

substantially below actual cost, earnings measured on such forward looking costs will not reveal that the carrier is actually losing money. This result is exacerbated by a plan which will apparently subtract revenues determined on the basis of historical cost from the defined forward looking costs.

The RTC has previously expressed its concern that a universal service support mechanism based on forward looking costs does not meet the law's requirements for "specific" and "sufficient" high cost recovery.[5] Congress envisioned a competitive market for telecommunications services, and the Joint Board interprets this to mean that universal support levels should be determined solely by forward looking costs. However, differences in prices are not based solely on differences in forward looking cost.[6] The Commission needs only to look at the recent activities of AT&T and MCI to see evidence of this principle.[7] In a market declared competitive by the Commission, it is reasonable to question whether AT&T and MCI are strictly recovering only their Total Element Long Run Incremental Costs (TELRIC).

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5 *See,* RTC Comments at 30, CC Docket No. 96-98, May 16, 1996.

6 Alexander Larson, "A Price is Not a Formula," *Public Utilities Fortnightly,* September 1, 1996, pp. 13-15.

7 In November, 1996, AT&T increased its domestic, direct-dialed, basic residential long-distance rates by 5.9 percent for nearly all services. MCI quickly followed AT&T's move by increasing its direct-dial and calling card rates 4.9 percent. Sprint also increased its basic rate by 2 percent.

2. THE COMMISSION SHOULD NOT REQUIRE FUTURE USE OF A YET-TO-BE-DETERMINED COST PROXY MODEL.

a. NO PROXY SYSTEM CAN BE ADOPTED WHICH HAS NOT BEEN VALIDATED TO DEMONSTRATE THAT IT REASONABLY PREDICTS WHAT IT PURPORTS TO PREDICT.

The Joint Board recommends that carriers draw high cost support based on the calculations of a cost proxy model.[8] While no particular model was endorsed,[9] the Joint Board recommends a schedule whereby non-rural companies would begin to use a cost proxy model for the purpose of universal service support starting January 1, 1998. Beginning in 2001, rural telecommunications carriers would begin a transition to the proxy methodology adopted for calculating high cost support in areas served by non-rural ILECs. The Joint Board recommends that universal service support for all carriers, including small and rural telephone companies, be solely based on a cost-proxy methodology by the year 2004.[10]

The RTC is very concerned that the Joint Board recommends requiring future use of a model when no model has even been proved to produce valid and reasonable outputs that predict what the model purports to predict, let alone provide for support levels will be "specific," "predictable," and "sufficient," as Section 254(b)(5) requires. The Joint Board states that the Commission should adopt a proxy model for which all "underlying data . . . [are] verifiable, engineering assumptions reasonable, and outputs plausible."[11] The RTC is concerned with the

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8 *Recommended Decision* at paras. 269-272.

9 *Id.* at para. 268.

10 *Id.* at para. 272.

11 *Id.* at para. 277.

lack of emphasis the Joint Board has placed on the verification of outputs. The word *plausible* is insufficiently rigorous[12] and does not adequately address the numerous comments the Commission has already received regarding the absence of proper validation of the proposed models.[13]

The Commission must *strictly* adhere to a criterion of output verification in assessing cost proxy models and should not mandate the use of a model for any practical purpose unless this criterion has been satisfied.[14] The proposed models must be shown to produce results comparable to studies of actual, forward looking cost.

While the Joint Board's *Recommended Decision* details some of the concerns surrounding the inputs of the proposed cost proxy models,[15] the Joint Board does not properly address concerns of the RTC and other commenters regarding the issue of verification. The Commission must continue to be wary of models that have yet to be verified as representative of observed, albeit forward looking data that the model intends to predict.

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[12] The first given meaning in *Webster's New Collegiate Dictionary* is: 1. *superficially* fair, reasonable, or valuable, *but often specious* <a ~ pretex>." (emphasis added)

[13] *See*, for example, Comments of Teleport Communications Group at 20, April 12, 1996, footnote omitted. *See also,* Comments of the Colorado Public Utilities Commission at 41, CC Docket No. 96-98, May 16, 1996 , RTC Further Comments at 7-11, CC Docket No. 96-45, August 9, 1996, and Comments of NTCA at 104, CC Docket No. 80-286, October 10, 1995.

[14] *See, City of Brookings Mun. Telephone Co. v. F.C.C.*, 822 F. 2d 1153, 1167-68 (D.C. Cir. 1987), holding that the Commission failed to engage in reasoned determination in approving average schedule modifications intended to resemble recovery obtained through cost studies. The Court found that gaps and anomalies in evidence supporting average schedule formula submission made it impossible to replicate or verify results.

[15] *Recommended Decision* at Appendix F.

As discussed in RTC's previous comments, proper testing of any model must involve actual engineering studies of at least a valid sample of Census Block Groups or grids.[16] Without such testing against individual market-specific facts, the accuracy of model results cannot be determined and the "forward looking" results cannot be verified.

b. NO PROXY SYSTEM IS LIKELY TO PREDICT COSTS ACCURATELY FOR ALL RURAL TELEPHONE COMPANIES; AN OPTION TO DEMONSTRATE INDIVIDUAL COSTS MUST BE PRESERVED.

The RTC has repeatedly expressed its concern over the danger of potential errors in proxy calculations, particularly for the small and rural carriers and their customers.[17] In its *Recommended Decision*, the Joint Board recognizes that small carriers will be significantly affected if the model does not accurately reflect their costs.[18]

Numerous commenters have pointed out a host of reasons why no one, administratively feasible model can be expected to "fit" and properly model costs for all companies. The RTC has serious concerns that no one model which is administratively feasible can also account for the multiple variables that determine the actual cost of serving a given area. Thus far, studies of the proposed proxies show that accounting for the multiple variables that determine costs for rural areas poses a problem for sponsors of the models.[19] The RTC is pleased that the Joint

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16 *Id.* at para. 277. *See,* NTCA Comments at 104, CC Docket No. 80-286, October 10, 1995.

17 *See,* for example, RTC Further Comments at 7-9, CC Docket 96-45, August 9, 1996.

18 *Recommended Decision* at para. 271.

19 *See,* National Exchange Carrier Association's (NECA's) Report on the BCM2, CC Docket No. 96-45, July 30, 1996. *See also, An Analysis of Universal Service Support Using Actual Book Costs*, Southwestern Bell Telephone Company, October 4, 1996.

Board recognizes the need to understand the unique circumstances surrounding small and rural companies[20] and strongly endorses the apparent commitment to a further proceeding to look at rural issues *before* implementation for rural LECs begins.[21] Yet concern remains that the eventual mandated use of any proxy for rural telephone companies will not provide the needed flexibility for underpredictions of cost, and therefore cannot meet the support requirements established in the Act.

An example of one of the most difficult cost issues associated with any system of universal service support is the allocation of joint and common costs. The Joint Board agrees that the adopted method for calculating cost must incorporate an allocation for joint and common costs.[22] The academic literature also supports the principal that minimum calculations of cost must include some contribution toward common costs.[23] Regardless of whether the universal service support system is based on cost proxy model calculations or some method of allocating actual costs, the issue of joint and common cost remains and must be addressed.

Nevertheless, the *Recommended Decision* of the Joint Board leaves this issue unresolved. Despite the fact that many commenters expressed concern that the cost proxy models do not accurately provide for recovery of joint and common costs, the Joint Board recommends without

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20 *Recommended Decision* at para. 271, 283-285.

21 *Id.* at paras. 279-282.

22 *Id.* at para. 277.

23 *See*, for example, Mark Jamison, "General conditions for Subsidy-Free Prices," *Journal of Economics and Business*, September, 1996.

specificity that carriers should be allowed to recover a "reasonable allocation" of joint costs.[24] The Joint Board then merely lists in an appendix the issue of joint and common cost recovery along with others that need to be addressed in future model workshops.[25] As discussed *infra.*, (p.7) the RTC believes that leaving the resolution of this and other critical issues to the outcome of the workshops while at the same time recommending that the Commission mandate the use of a yet-to-be-determined proxy model is improper. If the Commission adopts a proxy model as recommended by the Joint Board, it must ensure adequate recovery of joint and common cost in the model results.

c. A SERIES OF WORKSHOPS IS AN INSUFFICIENT BASIS FOR THE RECOMMENDATION THAT ALL COMPANIES MUST TRANSITION TO A SYSTEM OF UNIVERSAL SERVICE SUPPORT BASED ON A PROXY MODEL.

The Joint Board's adoption of a proxy implementation schedule, to be followed by workshops to develop a proxy, is reminiscent of at Alice's trial in *Through the Looking Glass.* "Verdict first, trial later." Any such "trial" must have adequate goals, ground rules and procedures.

Regulators, industry representatives, and academia generally agree with the following basic principal:

> Any plan for a more competitive telecommunications industry must have both: (1) long term vision that defines policy goals and appropriately matches them with regulatory instruments to achieve those goals, and (2) mechanisms for dealing with the transition

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24 *Recommended Decision* at para. 277.

25 *Id.* at Appendix F. On December 12, 1996, the Commission issued *Public Notice* DA 96-2091, specifying that workshops will be held on January 14-15, 1997.

from the current state of affairs to the one that is desired in the long term.[26] It appears that the Joint Board envisions the development of a revised universal service mechanism based on the use of a yet-to-be-developed cost proxy model that will work consistently with a newly competitive telecommunications market. However, the recommendation lacks an appropriate "game plan" to ensure that the development of a sufficient proxy model can be achieved. The RTC is willing to participate in the workshops to refine and modify the proposed models, and has recognized that further work on the models may provide substantial benefits.[27] However, the fact remains that the Joint Board's recommendation is based on the certain outcome of workshops that have not yet occurred.

The RTC is concerned that a series of workshops will prove to be an insufficient basis for the recommendation that all companies, including small and rural companies, transition to a system of universal service support based on a proxy model. An option to demonstrate individual costs must be preserved. The RTC reiterates that if a cost proxy model methodology is adopted for the purpose of universal service support, it must at the very least allow relief at the option of the carrier for underpredictions of actual costs. If the Commission opts to employ one of the proposed models, use of the proxies should be initiated on a voluntary basis only.[28]

The Joint Board suggests a time period of transition for small, rural companies, to allow

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[26] Barbara Cherry and Steven Wildman, "A Framework for Managing Telecommunications Deregulation while Meeting Universal Service Goals," May 11, 1996, at 3. Earlier version presented the *23rd Annual Telecommunications Policy Research Conference*, Solomons, Maryland, October 2, 1995.

[27] *See,* RTC Further Comments at 14, August 9, 1996.

[28] *Id.* at 21.

them to convert to a proxy methodology at the same time as non-rural companies if they elect to do so.[29] There will likely be a subset of rural companies that elect to use a proxy model at the same time as do the non-rural telecommunications carriers. In addition, rural carriers which continue to use embedded costs should also be allowed to use the proxy model, zones, or other appropriate apportionment to disaggregate support with their study area. For these reasons, if the Commission adopts the Joint Board's recommendation, it is critical that issues of concern for small and rural companies be addressed at the beginning of the implementation process in order for the model to have sufficient flexibility to address the unique concerns of rural LECs.

However, the RTC also agrees that the Commission must provide for the further development of the adopted cost model beyond the January 1, 1998 implementation date, as many issues will most likely remain unresolved. In addition to those issues identified in the Joint Board's recommendations, regulators and industry representatives have also not reached a consensus on many critical questions: who will determine input variables? How often will forward looking cost studies be updated? Most important, how can the model be flexible enough to incorporate changes in technology into forward looking cost estimates and produce outputs that can be verified for accuracy and reasonableness in each time period? There is substantial concern that the limited time frame will not provide ample time to address these ongoing issues of concern that may have a potentially enormous influence on the results of the model.

d. RURAL TELEPHONE COMPANIES' EMBEDDED COSTS SHOULD NOT BE FROZEN PENDING TRANSITION.

In conjunction with its proposed transition for rural companies to the use of a cost proxy

[29] *Recommended Decision* at para. 286.

model, the Joint Board recommends that support payments for high cost assistance be frozen at the per line amount of assistance received in 1997 beginning in 1998 and continuing to the end of the year 2000. These amounts are based on 1995 data. DEM weighting and Long Term Support benefits would be capped at the amounts received during calendar year 1996.[30]

Several times throughout this proceeding the Commission and the Joint Board have relied upon the work of economists to assist with the development of a proper universal service funding mechanism. The economic literature consistently asserts that the most desirable property of any funding mechanism is the promotion of economic efficiency, which is related to the rate of investment, or reinvestment:

> To serve the goal of dynamic efficiency, it is critical that the funding mechanism not discourage investments in, and experiments with, new technologies and services. Equally important is that funds be deployed to compensate for deficiencies in the market process in the promotion of new technologies and services.[31]

The RTC is concerned that the recommendations proposed by the Joint Board in the name of efficiency will, in fact, fail to provide an efficient result for small, rural telephone companies if the level of embedded costs must remain frozen pending transition. The RTC believes that this proposal will not allow for sufficient recovery of costs for ongoing infrastructure improvements during the period of transition and can only prove to be a disincentive for investment. Such a

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30 *Id.* at paras. 291-292. Note that because TS settlements are subject to a two-year "true up" provision, actual 1996 amounts of DEM weighting and Long Term Support benefits will not be known until the end of the 1998 pool year.

31 Bruce Egan and Steven Wildman, "Funding the Public Telecommunications Infrastructure," Telematics and Informatics, Vol. 11, No. 3, 1994. Dennis Weisman also discusses the fact that dynamic efficiency losses result from a sub-optimal level of investment in innovation. *See,* Weisman, "Asymmetrical Regulation: Principles for Emerging Competition in Local Service Markets," 18 *Telecommunications Policy*, 1994.

disincentive could prevent the appropriate modernization of the network, resulting in efficiency losses and degradation of service levels. If the Commission adopts the Joint Board's recommendation to transition to a viable cost proxy for universal service support, embedded costs should not be frozen pending transition.

The "freeze" actually turns the clock back and penalizes rural LECs that have made or planned investments in infrastructure since 1995. Investment for 1996 has been incurred by this late date in the year. Many commitments for 1997 have also been made. If investments are required to meet service demands which exceed the frozen level and the large company proxy, the rural company will be significantly deterred from improving service or unable to recover legitimate costs.[32]

Furthermore, the Joint Board suggests that the Commission freeze per line levels of support while at the same time require rural carriers to make contributions to the Universal Service Fund (USF).[33] This requirement in conjunction with the "freeze" would actually produce a net reduction for small, rural carriers which serve the highest cost areas. If the Commission adopts a plan whereby these carriers must make contributions during a "freeze" interval, at the very least the amount of the frozen per line support should be calculated net of contributions made to the support fund.

The claim as to need for efficiency incentives is unsupported. Nothing in the record shows

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32 The majority of rural telephone companies obtain capital financing through programs administered by the Rural Utilities Service of the U.S. Department of Agriculture. As a condition of receipt of loans, these companies are required to follow State Telecommunications Modernization Plans (STMP). The STMP requirements generally compel construction of facilities which exceed those needed to provide services defined as universal by the Joint Board. *See,* Rural Electrification Loan Restructuring Act of 1993, Pub. L. No. 103-129, 107 Stat. 1360 (1993), 7 C.F.R. 1751.

33 *Recommended Decision* at paras. 289-297.

rural companies are inefficient. Nevertheless, the Commission's study area waiver files demonstrate conclusively that major rebuilding and upgrading is underway or planned (often as a state commission requirement) and that these costs will substantially increase per line costs.[34] That increase will not be reflected in the frozen amounts. The freeze would make it impossible to make the improvements promised in these cases, which improvements were made necessary by the failure of the previous owners to make investments sufficient to provide universal service as defined in the recommendation.

e. THE UNIVERSAL SERVICE RULES MUST BE COORDINATED WITH ANY CHANGES IN ACCESS AND SEPARATIONS RULES.

The RTC has long advocated that the Commission combine, or at least coordinate the issues dealing with universal service support and access reform, including any separations changes involved in either.[35] The Joint Board's discussion of potential changes to the Subscriber Line Charge and Carrier Common Line charge[36] reinforces this necessity. The simple fact is that rural telephone companies obtain, on average, 65% of their revenue from access (including universal service

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[34] For example, in 1995, the Commission granted the Joint Petition of US West Communications, Inc. and Eagle Telecommunications, Inc. for Waiver of the Definition of "Study Area" Contained in Part 36, Appendix-Glossary of the Commission's Rules. Eagle Telecommunications estimated that its acquisition of 43 exchanges from US West would increase annual support payments from the USF by approximately $18.1 million, of which $3.6 million would be directly attributable to the upgrading of the facilities. *See,* Eagle Telecommunications, Inc., Joint Petition for Waiver of the Definition of "Study Area" Contained in Part 36, Appendix-Glossary of the Commission's Rules and Eagle Telecommunications, Inc., Petition for Waiver of Section 61.41(c) of the Commission's Rules, AAD 94-27, FCC 95-4 released January 5, 1995.

[35] *See,* RTC Reply Comments at 23, CC Docket No. 96-45, May 7, 1996.

[36] *Recommended Decision* at paras. 769-776.

support) and most of the remainder from local service.[37] In order for rural telephone companies to be able to continue to provide service at rates which meet the requirements of the 1996 Act, i.e., just, reasonable, affordable, and reasonably comparable to urban rates, the balance between these revenue sources must be maintained. The Commission cannot therefore find that a certain level of universal service support is specific, predictable and sufficient in one proceeding based on an assumed level of access revenue, and then substantially reduce that level in another proceeding.

Also, despite, considerable discussion during the Joint Board's open meetings, the legal requirement to maintain jurisdictional separations rules was not eliminated by the passage of the 1996 Act. Although the federal-state relationships have been revised in certain respects, the fact remains that telephone companies are still subject to regulation of services by state and federal agencies where the same facilities are used for both services. In these conditions, the rule of *Smith v. Illinois Bell,*[38] that there must be some division of the investment, expenses and revenues, cannot be avoided. Thus, the Commission needs to include in its coordination any changes in the Part 36 rules. Such changes, of course, require a Section 410(c) Joint Board.

Finally, despite the probable reversal of the Commission's position as to its jurisdiction to prescribe pricing rules for interconnection, reciprocal compensation, unbundled elements and resale,[39] any universal service decision must take into account the changes in carriers' revenue streams as a result of competitive carriers activities.

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[37] *See, 1994 Statistical Report of Rural Telecommunications Borrowers*, Rural Utilities Service, March 1995, Table 1.

[38] *Smith vs. Illinois Bell Tel. Co.*, 282 U.S. 133 (1930).

[39] The United States Court of Appeals for the Eighth Circuit temporarily stayed the *First Report and Order* in *Iowa Utilities Board v. FCC,* No. 96-3321 on September 27, 1996.

f. COMPETITIVE LECS SHOULD NOT RECEIVE SUPPORT BASED ON EMBEDDED COST OF RURAL INCUMBENTS LECS.

The Joint Board recommends "that the Commission make frozen support payments portable."[40] In other words, if a competitive LEC (CLEC) "wins" a customer from the ILEC, it receives the exact amount of universal service support that previously flowed to the ILEC irrespective of whether the CLEC uses the LEC's loops or whether it obtains access through unbundling or resale.[41] The Joint Board recommends the use of the ILEC's embedded costs due to the principle of "competitive neutrality." Unfortunately, the use of ILEC costs for CLEC support is actually contrary to the principle of competitive neutrality and would give a CLEC an unfair competitive advantage.

Support for the ILEC is averaged throughout the entire study area. The ILEC receives the same amount of support for a nearby customer in town 100 yards from the central office that it receives for a remote farmhouse 10 miles out. Obviously, the difference in cost to serve these two customers is extreme. Because CLECs can qualify for support by providing facilities only to the low-cost, high-volume nearby town customers, while using resold facilities of the incumbent to meet its obligation to serve anyone else in the study area, it will receive a windfall if it obtains the average support. The Joint Board's statement that

[b]ecause CLECs must provide service to and advertise its service throughout the entire

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40 *Recommended Decision* at para. 296.

41 Unaccountably, the Joint Board recommends (*Ibid.*) Shifting support to a CLEC even if it is using resale or unbundled elements for portions of its service. The RTC has consistently argued that sufficient universal service support must flow to the provider of facilities since the Act mandates in Section 254(e) that "[a] carrier that receives such support shall use that support only for the provision, maintenance, and upgrading of facilities and services for which the support is intended."